

Giving Credit Where Credit is Due: How to pay for an improvement in the Earned Income Credit

Advocates for Oregon's low-income working families with children want to improve Oregon's Earned Income Credit (EIC) to eliminate Oregon's income tax on the working poor. They asked OCPP to suggest a revenue source to pay for the EIC's improvement. This paper sets forth OCPP's proposal.

Brief background on the EIC improvement

Oregon is one of a minority of states that continues to assess an income tax on working families living in poverty. The trend nationally is for states to eliminate income taxes on working poor families, in part to help these working families achieve self-sufficiency. The 2006 Oregon income tax for a family of four with income at the poverty line - \$20,615 - was \$319, the fifth highest amount in the country.¹

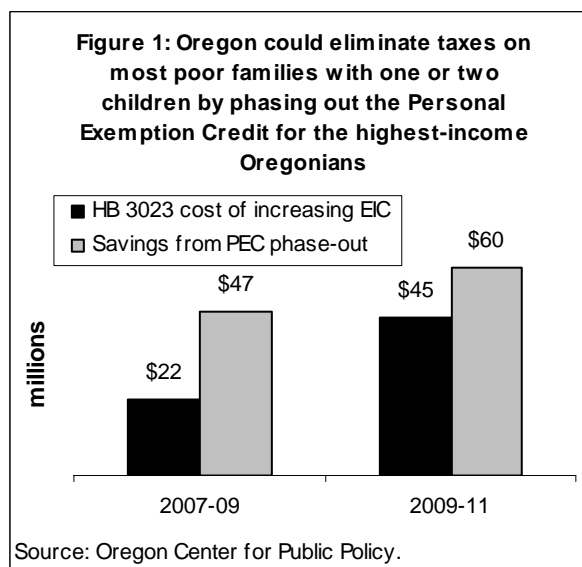
Oregon could eliminate income taxes on most poor families with one or two children by expanding the state Earned Income Credit from five percent to twelve percent of the federal Earned Income Credit, as the OCPP has detailed in *Working, Poor, and Taxed: Improving Oregon's Earned Income Credit*.²

Two bills introduced in the 2007 legislative session would increase Oregon's EIC to twelve percent of the federal credit. HB 3023 would cause the increase to occur in tax year 2008, the same year the current credit is set to increase from five percent to six percent of the federal credit. HB 2398 would phase-in the increase over the six years from 2007 to 2012.

The cost of HB 3023 is in the range of \$22-\$31 million in 2007-09 and \$45-\$51 million in 2009-11. The cost of HB 2398 is in the range of \$16-\$19 million in 2007-09 and \$29-\$35 million in 2009-11.³

Proposal to pay for improving the EIC

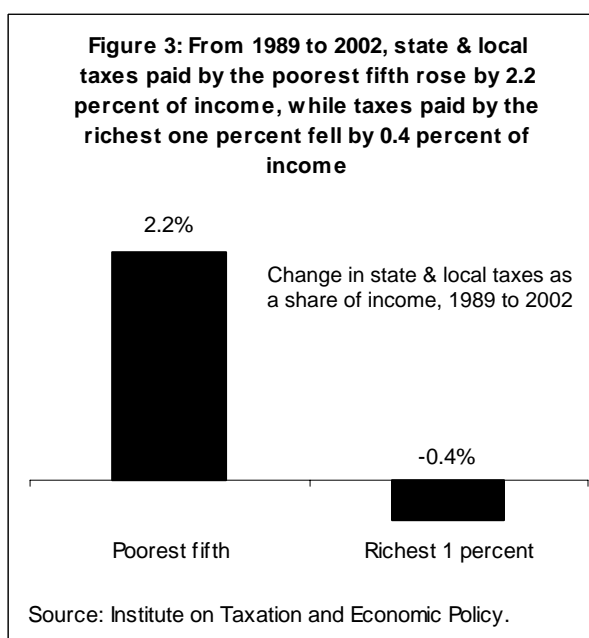
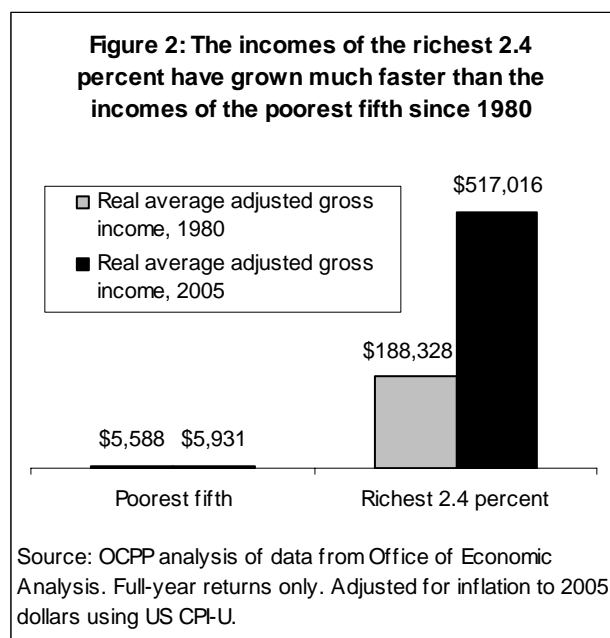
The cost of improving the EIC could be covered by phasing out the personal exemption credit for high-income Oregonians. The OCPP estimates that eliminating the personal exemption credit for taxpayers with adjusted gross incomes over \$200,000 beginning in tax year 2007 would raise \$47 million in 2007-09 and \$60 million in 2009-11.⁴ If the change did not occur until tax year 2008, it would raise \$22 million in 2007-09. Hence, phasing out the personal exemption credit for high-income Oregonians could cover the cost of increasing the Earned Income Credit (Figure 1).



Widening inequality and the tax shift to low-income Oregonians

Phasing out the personal exemption credit for the highest-income Oregonians to pay for an increase in the state Earned Income Credit would not only make Oregon's income tax system more progressive, it would also serve to counteract the impact of widened income inequality in Oregon. In tax year 2005, only the highest-income 2.4 percent of full-year Oregon taxpayers had adjusted gross incomes over \$200,000. From 1980 to 2005, the highest-income 2.4 percent of Oregon households saw their adjusted gross incomes come close to tripling, even after adjusting for inflation.⁵ The inflation-adjusted average adjusted gross income of this group rose from \$188,328 in 1980 to \$517,016 in 2005, an increase of nearly \$329,000 (Figure 2).

By contrast, the adjusted gross incomes of the lowest-income fifth of Oregon taxpayers (excluding those with negative incomes) has grown by just six percent since 1980, after adjusting for inflation.⁶ These taxpayers had average adjusted gross incomes of \$5,931 in 2005, up from \$5,588 in 1980 – an increase of just \$342 above inflation (Figure 2).



Oregon has exacerbated the impact of widening inequality by cutting taxes as a share of income for the rich while raising taxes as a share of income for low-income families. From 1989 to 2002, taxes paid by the lowest-income fifth of all families in Oregon grew by 2.2 percent of income.⁷ By contrast, taxes paid by the highest-income one percent fell by 0.4 percent of income (Figure 3). For the highest-income five percent, taxes fell by 0.2 percent of income.

Conclusion

The improvements in the state EIC can be accomplished by phasing out the personal exemption credit for those households at the top of the income scale whose incomes have skyrocketed and whose state and local taxes have declined as a share of income.

Endnotes:

¹ Levitis, Jason, *The Impact of State Income Taxes on Low-Income Families in 2006*, Center on Budget and Policy Priorities, March 27, 2007. Available at <http://www.cbpp.org/3-27-07sfp.htm>.

² Leachman, Michael, *Working, Poor, and Taxed: Improving Oregon's Earned Income Credit*, Oregon Center for Public Policy, April 4, 2007. Available at <http://www.ocpp.org/cgi-bin/display.cgi?page=070404EIC>.

³ The range reflects the estimates by OCPP and the Legislative Revenue Office as discussed in Leachman, Michael, *Working, Poor, and Taxed: Improving Oregon's Earned Income Credit*, Oregon Center for Public Policy, April 4, 2007. Available at <http://www.ocpp.org/cgi-bin/display.cgi?page=070404EIC>.

⁴ OCPP estimate based on estimated total personal exemption credits in future years and estimated share of personal exemption credits that will be received by taxpayers with adjusted gross incomes over \$200,000 in future years. Estimate of 2007-09 total personal exemption credits from Oregon Department of Revenue and Oregon Department of Administrative Services, *2007-09 Tax Expenditure Report*. OCPP estimated 2009-11 total exemption credits based on growth in total exemption credits between 2005-07 and 2007-09, as reported in the Tax Expenditure Reports. Share of personal exemption credits received by taxpayers with incomes over \$200,000 in 2005 supplied to OCPP by Damon Bell, Oregon Department of Revenue by email on March 20, 2007. OCPP adjusted the 2005 share for estimated growth in share of taxpayers with incomes over \$200,000 from 2005 forward based on historical percentage growth in the share of taxpayers with adjusted gross income over \$200,000.

⁵ OCPP analysis of Office of Economic Analysis data. Adjusted for inflation using US CPI-U.

⁶ Ibid.

⁷ Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, 2nd edition, January 2003, p. 91.

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